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No. 92-1074

In The

Supreme Court of the United States

October Term, 1992

JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY,

Petitioner,

v.

HARRIS TRUST AND SAVINGS BANK, as Trustee of the Sperry Master Retirement Trust No. 2,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF *AMICUS CURIAE* THE ATTORNEY GENERAL OF THE STATE OF NEW YORK IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

Robert Abrams
Attorney General of the State of New York

Jerry Boone*
Solicitor General
Department of Law
120 Broadway
New York, New York 10271
(212) 416-8020

* Counsel of Record

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The Attorney General of the State of New York respectfully submits this brief on behalf of the Superintendent of Insurance of the State of New York as *amicus curiae* in support of the Petition of the John Hancock Mutual Life Insurance Company ("John Hancock") for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

STATEMENT OF INTEREST OF *AMICUS CURIAE*

The Superintendent of Insurance of the State of New York (the "Superintendent"), as head of the Department of Insurance (the "Department"), regulates the business of insurance in the State of New York. The Superintendent is responsible for monitoring and regulating insurers that do business in New York, such as petitioner John Hancock, and for regulating the content and sale of the insurance products that those insurers offer, such as the group annuity contract that is the subject of this lawsuit ("GAC 50").[1] This task is enormous and complex. In 1992 there were 87 life insurance companies domiciled in New York and another 142 licensed to do business in the State. In 1991, these insurers received premiums in New York for annuities alone totaling $4.059 billion. They received total premiums of $30.616 billion. *See* American Council of Life Insurance, *1992 Life Insurance Fact Book*, at 74 (1992). Nationwide, as of December 1991, life insurance companies under contract with retirement plans held approximately $565 billion out of a total of $746 billion in reserves under general account contracts such as GAC 50. *Id.* at 58.

The Superintendent's foremost duty is the protection of the insuring public through enforcement of New York's comprehensive legislation governing the business of insurance in New York. This legislation both ensures the financial stability of insurers doing business in New York and protects the public by strictly prohibiting unfair discriminatory treatment of policyholders and contractholders. As set forth below, the Superintendent has a significant interest in

1. John Hancock is licensed as an insurer in the State of New York. GAC 50 was issued in New York and was reviewed and approved by the Department. The contract expressly states that it is governed in all respects by New York law.

this litigation for three reasons: first, the decision of the Second Circuit, which imposes the fiduciary responsibility provisions of the Employee Retirement Income Security Act of 1974, as amended, 29 U.S.C. Sections 1001-1426 ("ERISA"), on an insurer's management and administration of its general corporate assets, will interfere with the nondiscriminatory treatment of policyholders and contractholders required by State law; second, the decision will interfere with the State's ability to ensure the financial stability of insurance companies operating in the State; and third, application of the decision to contracts and arrangements that have been in effect for years will severely impair the administration of the insurance laws by insurance regulators.

SUMMARY OF ARGUMENT

Premiums paid to an insurance company under a group annuity contract such as GAC 50, unless allocated to a separate account, become part of the insurer's general corporate assets, commonly known as the insurer's "general account."[2] General account assets are not segregated for the benefit of particular contractholders. In monitoring the solvency of an insurance company, the Superintendent and the Department do not match specific liabilities with specific assets, but compare total liabilities with the general account's aggregate assets.

The Second Circuit's decision would disrupt the Department's regulation of the insurance industry by requiring insurers to manage certain general account assets "solely in the interest of the [plan's]

2. An insurance company uses its general account to pay its operating expenses (*e.g.*, salaries, rent and taxes), obligations to general account contractholders, obligations to creditors, and dividends to contractholders and policyholders.

participants and beneficiaries and . . . for the exclusive purpose of . . . providing benefits to participants and their beneficiaries . . . ." ERISA § 404(a)(1) (29 U.S.C. § 1104(a)(1)). By compelling insurers to give general account funds that are deemed to be "plan assets" preferential treatment in favor of ERISA contractholders, the Second Circuit in effect requires unfair discrimination against other contractholders in violation of State law. Moreover, because the decision apparently accords "plan assets" a status separate and apart from other general account assets, it is now unclear whether these funds may be used to offset an insurer's general account liabilities, or indeed whether they are assets of the insurer at all. The decision thus interferes with the Superintendent's ability, under long-established, statutorily mandated accounting procedures, to monitor and ensure the financial well-being of insurance companies.

Application of the decision to existing insurance contracts and practices would wreak havoc on the regulation of the insurance industry. Because of this momentous impact on the fair and equitable regulation of insurance, the Superintendent urges the Court to grant certiorari.

ARGUMENT

CERTIORARI IS APPROPRIATE BECAUSE THE SECOND CIRCUIT'S DECISION IMPERMISSIBLY INFRINGES UPON STATE REGULATION OF THE INSURANCE INDUSTRY

As this Court has recognized as recently as 1990, the regulation of insurance is an area of traditional state regulation that Congress did not intend to preempt. *FMC Corp. v. Holliday*, 111 S. Ct. 403, 410 (1990). Congress itself made this intention plain in the McCarran-Ferguson Act, 15 U.S.C. Sections 1011-1015, which provides that the "business of insurance, and every person engaged

therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business." 15 U.S.C. § 1012(a). Indeed, the savings clause of ERISA itself exempts State insurance law from ERISA preemption: "nothing in this title shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities." ERISA § 514(b)(2)(A) (29 U.S.C. § 1144(b)(2)(A)). *See generally* 111 S. Ct. at 409-10. Because the Second Circuit's decision substitutes the fiduciary requirements of ERISA for various state regulatory provisions regarding the allocation, management, and administration of an insurer's general account assets, it should be reviewed and reversed.

A. The Second Circuit's Decision Requires Insurers To Discriminate Against The Holders Of Contracts Not Subject To ERISA In Violation Of State Law

Generally, insurance is the equitable spreading of risk among a large number of policyholders or contractholders backed by the pooled assets of the insurer's general account. Those pooled assets are available to satisfy claims made under each of the policies or contracts. While New York pursues its goal of equitable treatment of policyholders through a number of statutory provisions,[3] the Second Circuit's decision would frustrate the effectiveness of those provisions.

3. *See, e.g., Health Ins. Ass'n v. Corcoran*, 154 A.D.2d 61, 68, 551 N.Y.S.2d 615, 618 (3d Dept. 1990) ("'The function of [the Department of Insurance] is to ensure equity both to policyholder and company, not only in rates but in the extremely important realm of giving the public proper coverage in return for premium payments' . . . .") (quoting *Public Serv. Mut. Ins. Co. v. Levy*, 87 Misc. 2d 924, 926, 387 N.Y.S.2d 962, 964 (Sup. Ct. N.Y. Co. 1976), *aff'd*, 57 A.D.2d 794, 395 N.Y.S.2d 1 (1st Dept. 1977).

Section 4224(a)(1) of the Insurance Law, for example, states:

> (a) No life insurance company doing business in this state and no savings and insurance bank shall:
>
> (1) *make or permit any unfair discrimination between individuals of the same class* and of equal expectation of life, in the amount or payment or return of premiums, or rates charged for policies of life insurance or annuity contracts, or in the dividends or other benefits payable thereon, *or in any of the terms and conditions thereof* . . . .

N.Y. Ins. Law § 4224(a)(1) (emphasis added). Similarly, Article 74 of the Insurance Law, which sets forth procedures for the rehabilitation and liquidation of domestic insurers, establishes priorities for the distribution of the general account assets of an insurer's estate among claimants, including annuity contract claimants. Section 7435(a) specifies that, within each of the eight classes established for the distribution of assets, "[n]o subclasses shall be established."[4]

By requiring insurers to manage certain general account assets "solely in the interest of the [plan's] participants and beneficiaries

4. Section 7435(b) does permit an exclusion from the distribution priorities for claims under a "separate account":

> "Every claim under a separate account agreement providing, in effect, that the assets in the separate account shall not be chargeable with liabilities arising out of any other business of the insurer shall be satisfied out of the assets in the separate account equal to the reserves maintained in such account for such agreement . . . ."

Section 7435(b) is a statutorily created exclusion with no application to the general account funds at issue in this litigation.

and . . . for the exclusive purpose of . . . providing benefits to participants and their beneficiaries," the Second Circuit's decision in effect compels precisely the kind of "unfair discrimination" prohibited by Section 4224, and precisely the type of "subclass" explicitly rejected by Section 7435.[5] Under the Second Circuit's decision, an insurer faced with two contractholders—one an ERISA plan and one not—must favor the ERISA plan contractholder with fiduciary treatment to which the other is not entitled.[6] Even if the terms of their contracts were identical, federal law would superimpose a differentiation that is not there and was not there when the contracts were purchased. It would, for example, require insurers to make investment decisions for ERISA contractholders based upon a different standard from that applied to other contractholders of the same class, perhaps to the detriment of such other contractholders, and to allocate income and expenses to ERISA contractholders on a preferential basis. Such a result is inconsistent with the basic investment and income and expense allocation standards embodied in Articles 14 and 42 of the Insurance Law, and contrary to statutory provisions intended to promote equitable treatment of and avoid unfair discrimination

5. Because Section 7435 groups all claims made under insurance policies and annuity contracts in a single class, any disparity in the treatment of annuity contractholders based upon their status under ERISA would effectively create a subclass in violation of Section 7435.

6. Under New York law, an insurance company is not a fiduciary to its policyholders. *See, e.g., Rochester Radiology Associates, P.C. v. Aetna Life Ins. Co.*, 616 F. Supp. 985, 988 (W.D.N.Y. 1985).

among the holders of policies or contracts.[7] This result contradicts ERISA's savings clause.

B. The Second Circuit's Decision Conflicts With New York's Statutory Scheme For Monitoring The Solvency Of Insurers

The underlying purpose of insurance is the provision of contractually specified benefits that may come due at some future date. The level of benefits, the date for their payment, or both may be unknown at the time of the issuance of the policy or contract. Assuring the ability of an insurer to meet these obligations is a central goal of New York's system of insurance regulation.

7. Section 1405 of the Insurance Law regulates generally the investments of life insurers. Section 4239 authorizes the Superintendent to promulgate regulations ". . . prescribing standards for the *equitable allocation of income and expenses* as among lines of business and as between investment expenses and insurance expenses" by life insurers (emphasis added). These standards, as established by Insurance Department Regulation No. 33, indicate that:—"It is the responsibility of each life insurer to use only such methods of allocation as will produce a suitable and equitable distribution of income and expenses . . . ." N.Y. Comp. Codes R. & Regs. tit. 11, § 91.4(a)(1).

Other provisions of the Insurance Law also prohibit discrimination of the type the Second Circuit's decision requires. Section 3201 of the Insurance Law authorizes the Superintendent to reject "any form of annuity contract . . . for delivery or issuance for delivery in this state, *if its issuance would be prejudicial to the interests of policyholders or members or it contains provisions which are unjust, unfair or inequitable.*" N.Y. Ins. Law § 3201(c)(2) (emphasis added). The Second Circuit's decision would effectively incorporate obligations into annuity contracts purchased by ERISA plans that would unfairly discriminate against other holders of general account contracts to which ERISA does not apply.

Requiring an insurer to act "solely in the interest" of a favored subgroup of participants and beneficiaries, however, would significantly frustrate the Superintendent's ability to monitor an insurer's solvency and financial well-being under the statutory accounting practices mandated by State law.

The basic and long-standing benchmark for review of an insurer's financial condition requires a comparison of the insurer's total "admitted assets" (as defined in Section 1301 of the Insurance Law) with the total amount of its reserves and other liabilities.[8] Admitted assets are grouped for statutory financial reporting purposes by category (*i.e.*, common stocks, preferred stocks, bonds, real estate, mortgage loans, etc.). No differentiation is made or required to be made based upon the source of the asset or the funds used to acquire it. Section 1301(a) of the Insurance Law requires that an "admitted asset" be "owned" by the insurer.

The Second Circuit's decision obstructs this scheme by bringing into question the status of funds subject to fiduciary treatment. It is no longer clear that these funds are "assets" beneficially owned by the insurer as the Department has previously understood and applied that term. If an insurer is regarded as an administrator of funds that it is not deemed to own (because they are plan assets), these funds might not be viewed as assets of the insurer available to be offset against its liabilities. Such an inability to treat those funds as admitted assets would create an imbalance in an insurer's admitted assets on the one hand and its reserves and other liabilities on the other, potentially creating the basis for a

8. Insurers licensed in the State are required to maintain a minimum "surplus to policyholders," as set forth in the Insurance Law, based upon the lines of business that they write. Section 107(a)(42) defines the surplus to policyholders as "the excess of total admitted assets over the liabilities of an insurer."

determination that it is insolvent.[9] Under New York statutory provisions, the Superintendent would then be authorized to suspend or revoke the license of a foreign or alien insurer or to place a domestic insurer in rehabilitation or liquidation.[10]

In essence, the Second Circuit's decision could be construed to create a new category of asset (if it is an asset of the insurer at all) not specifically authorized by State law. On the one hand, funds subject to ERISA fiduciary treatment are not necessarily general account assets against which the general liabilities of the insurer can be offset. On the other, it is clear that they are not separate account assets immune to such offsetting.[11] They are, apparently, a judicially created hybrid, a general account asset that may not be used to satisfy claims on the general account. This hybrid status, however, impermissibly discriminates against non-ERISA contractholders: whereas the liabilities owing to the non-ERISA contractholder are secured by the general account only—and not by the funds subject to ERISA fiduciary treatment—the liabilities owing to the ERISA contractholder would appear to be secured by

9. N.Y. Ins. Law § 1309(a).

10. N.Y. Ins. Law §§ 1309(b), 7402(a) and 7404.

11. Separate account assets, while assets of the insurer, may not be used to satisfy claims on the insurer's general account. Section 4240 of the Insurance Law, governing separate accounts, provides the exclusive means for insulating assets from general account liabilities. Such separate account assets are specifically excluded from the estate of a domestic life insurer in applying the scheme for the distribution of claims of Section 7435. To the extent that the Second Circuit's decision attempts to insulate assets from general account liabilities through its imposition of fiduciary treatment on certain assets in the general account, it does so inconsistently with Section 4240.

the segregated funds receiving fiduciary treatment *and* by the entire general account.[12]

C. Application Of The Second Circuit's Decision To Existing Contracts And Practices Would Massively Complicate The Regulation Of Insurance In New York

The application of the Second Circuit's decision retroactively will have an enormous impact both on the administration of the Insurance Law by the Department and on the insurance industry's handling of the billions of dollars already contributed under group annuity contracts such as GAC 50. The ruling will expose insurers to potentially large liabilities for breach of heretofore unimagined fiduciary obligations under ERISA—including challenges to investment, income allocation, and dividend practices that comply with State law—and will require them somehow to bring their general accounts into compliance with the court's decision.[13]

If upheld, the Second Circuit's decision would effectively require a two-tiered regulatory scheme that the Department would have to oversee in areas of insurance law involving ERISA-covered pension plans: one State-law tier applying to non-ERISA funds and

12. The Second Circuit's decision does not answer the complex question of *how* funds subject to fiduciary treatment would be identified and segregated from the currently unsegregated corpus of an insurer's general account.

13. Because this potential for liability (and the uncertainty regarding the status of general account assets subject to ERISA fiduciary obligations) would apply only to insurers writing ERISA-related business and would have the most severe impact on those insurers with the largest volume of such business, affirmance of the Second Circuit's decision could deter insurers from writing such contracts in the future.

ERISA funds not considered "plan assets," and one federal tier for funds deemed "plan assets." As demonstrated above, such a change would necessarily and extensively complicate the Department's regulation of insurance, including the Department's evaluation of the solvency of insurers.[14]

To avoid the unwarranted complication of the regulation of insurance by all fifty states, the Court should review and reject the Second Circuit's decision.

14. Until now, all general account assets of an insurer have been available to satisfy all of the insurer's general obligations, without regard to the identity or status of particular policyholders or contractholders. Insurers have to date prepared financial statements and the Department has reviewed them on that basis. The Second Circuit's decision, however, suggests that certain general account assets may not be available for those purposes, and therefore calls into question the accuracy of the information currently provided in such statements. It should be noted that a wide segment of the public, including policyholders, contractholders, lending institutions, investors, investment bankers, reinsurers, and other insurers, relies on insurers' statutory financial statements for accurate information regarding admitted assets and liabilities.

CONCLUSION

For all the foregoing reasons, *amicus curiae* the Attorney General of the State of New York, on behalf of the Superintendent of Insurance of the State of New York, respectfully urges that a Writ of Certiorari be granted.

January 21, 1993

Respectfully submitted,

ROBERT ABRAMS
Attorney General of the State of New York

JERRY BOONE
Counsel of Record
Solicitor General

Department of Law
120 Broadway
New York, New York 10271
(212) 416-8020

Submitted on Behalf of the Superintendent of Insurance of the State of New York